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TAGS: ENRG EMIN CO
SUBJECT: MINING SECTOR OVERVIEW

REF: A. BOGOTA 2880

¶B. BOGOTA 5979

¶1. Summary. Colombia,s success in reforming regulation of the mining industry has enhanced the sector,s international competitiveness, created a more attractive investment climate, and in conjunction with similar reforms in the oil and gas sector (see reftel A) made the extractive sector the principal recipient of foreign direct investment in 2004. The 2001 mining code improved contractual terms and stability, streamlined bureaucratic procedures and resulted in a large increase in private sector investment. The country is the largest producer of coal in Latin America and is an important producer of emeralds, gold, ferronickel and platinum. During 2003, mining activity showed a significant increase in production volume and exports. Growth in 2004 was significantly less, with the exception of coal and ferronickel, which topped historic levels. End Summary.

Legal Framework: Colombia's Forward-Leaning Mining Code

¶2. The Colombian Mining Code, passed by Congress on August 15, 2001, provides contractual stability and more favorable economic concessions for private investors. The 2001 code streamlined the previous 11 different types of concession agreements between private investors and the state into one agreement, and significantly reduced the bureaucratic requirements needed to sign a concession agreement with the Colombian government. The new concession system maintains a thirty-year term, and provides for the extension of up to 30 additional years upon the concessionaire,s request. The 2001 code eliminated the one to two year exploration license previously required for a concession to be ultimately granted. Exploration licenses are now included in the 30-year concession term, and are granted for a maximum of three years, with a possible two-year extension. In addition, the previous four-year window for construction and installation has been reduced to three years, extendable for an additional year within the concession term. According to Jairo Herrera, Director of Mining at the Colombian Mines and Energy Planning Unit (UPME), the avalanche of requests for concession agreements from private investors throughout the country is evidence of the code,s success.

¶3. The 2001 code protects contract terms for old concessions and makes them eligible for the enhanced conditions offered by the new code. Old concession holders maintain the right to exploit new mineral findings under the same contract. Also, the code enhances contractual stability by keeping all royalty payments and re-adjustments agreed under previous regulations constant.

¶4. Under the previous law, all mining assets and infrastructure became GOC property if a mining concession expired or was renounced after the twentieth year of production. The 2001 code allows concessionaires to renounce mining rights at any time during the contract term or withdraw all production and related right-of-way assets.

¶5. Foreign companies expecting to develop permanent business in the mining sector must establish a branch or a legal presence in Colombia. If the business is occasional or temporary, a general attorney domiciled and resident in Colombia must be appointed.

Fees, Royalties, and Taxes

¶6. The GOC receives ground fees and royalties in exchange for mining concessions. During the exploration phase, license holders pay yearly ground fees equivalent to a minimum daily salary (approximately USD 5) per hectare of exploration land. Small mining projects of less than 10 hectares are exempt from ground fees.

¶7. When the commercial exploitation phase begins, license holders begin paying royalties to the government. Royalty rates range from 3 to 12 percent depending on mineral type. Departments and municipalities located at the exploitation site share in royalty revenues; ports through which mining

products are transported are also eligible. Remaining royalty payments are deposited in a National Royalty Fund (NRF). The NRF distributes royalties to other territorial entities for use in promotion of mining, environmental protection, and investment in regional development projects focused on electrification and road network projects. To access NRF funds, governors and mayors must present investment projects endorsed by the Ministry of Mines and Energy and approved by the National Planning Department.

¶8. Mining companies receive tax benefits but also pay production-related taxes. Companies receive exclusions for assets devoted to mining activities while exporters receive a thirty-year tax and levy exemption if they commit five percent of their FOB value of annual exports to re-forestry projects. Production-related taxes constitute a substantial share of the tax burden for mining companies in Colombia. In general, the government takes in 46 percent of the cash flow of mining projects. Colombia also has customs duties and import tax exemptions on machinery and technical equipment imported for mineral exploration.

Overall Production Trends

¶9. Colombia is the largest producer of coal in Latin America and is a leading exporter of gold and emeralds. The country also produces platinum, ferronickel, silver, zinc, limestone, iron-ore, lead, steel, copper, phosphates, sulfur, and uranium. Colombia,s mining output (excluding petroleum) grew from 67.6 million tons in 2003 to 72.6 million tons in 2004, an increase of 7.4 percent. Total mining exports (excluding hydrocarbons) reached USD 3.4 billion in 2004, a 24.7 percent increase from 2003 levels. The 2004 total mining export figure represents approximately 3.5 percent of GDP.

Coal

¶10. Colombia is increasing production of its significant reserves of high-quality coal and has proven coal reserves of 7.3 billion tons. Most of Colombia,s coal reserves consist of high-quality bituminous coal, with a sulfur content of less than one percent. Coal production increased seven percent, from 50 million tons in 2003 to 53.5 million tons in ¶2004. Colombian coal exports went from USD 1.4 billion in 2003 to USD 1.7 billion in 2004.

¶11. Over 90 percent of Colombian coal production occurs in large-scale open cast mining operations in the northern departments of La Guajira and Cesar. In La Guajira department, Cerrejon Zona Norte is one of the highest quality thermal deposits in the world. Site production started in 1985 at a rate of 1.5 million tons per year and has now increased to 22 million tons per year; an output of 28 million tons is planned for 2007. A partnership between Anglo American, BHP Billiton, and Glencore has a contract to operate Cerrejon Zona Norte and Carbones del Cerrejon mine until 2033. BHP Billiton owns 33.3 percent of the Cerrejon mine and 99.8 percent of the Cerromatoso nickel mine. In Cesar department, Drummond Coal (USA) operates another major project at La Loma that contains estimated reserves in excess of 534 million tons (see reftel B for details of Drummond,s expansion). Drummond,s contract with the GOC runs through ¶2019. La Guajira and Cesar production is for export, mainly to Western Europe and the United States.

¶12. Colombia also has a large amount of traditional small to medium-sized block caving mines in the Andean Mountains. These mines comprise the majority of coal mines and coal miner employment in Colombia. Production from these mines services domestic demand, mainly to meet power generation needs. Approximately 1,000 mines (about a third of the total) are illegal and are generally small-scale underground operations. Domestic coal prices are about a fourth of export prices.

¶13. In early 2003, the Colombian Mining Association (Asomineros) and the GOC launched a campaign to promote coal exports to other Central and South American countries and to improve transportation capacity constraints. In mid-2003, the GOC earmarked USD 320 million for infrastructure development to increase coal export capacity. Part of the investment will fund the construction of a second rail line linking the Cesar region with Santa Marta port on the Atlantic coast.

Copper

¶14. Colombian copper production and exports increased from 2003 to 2004. Total copper production went from 8,526 tons in 2002 to 7,270 tons in 2003 and increased to 7,840 tons in

¶2004. Copper exports went from USD 3.2 million in 2003 to USD 5.9 million in 2004. Production comes almost entirely from the El Roble mine in Choco Department. The mine, owned by Minera El Roble S.A., began production in 1990. In the early 1990s, El Roble had reserve estimates of about one million metric tons of ore. The mine had a production capacity of 96,000 t/yr of crude ore and 14,000 t/yr of copper concentrate. According to UPME,s Mining Director, Jairo Herrera, based on production levels for the past 14 years, the mine will be depleted in the near future. All production of copper concentrate was exported to Japan. Copper in smaller quantities was also produced in Ancuya Narino Department and El Dovio in Valle Department. Colombia also produces secondary copper from scrap.

Iron and Steel

¶15. Colombia is one of Latin America,s major steel importers. The country,s steel industry is small, comprising only 2.3 percent of total manufacturing output. Total iron and steel production went from 625,000 tons in 2003 to 642,546 tons in 2004. Colombia,s main integrated steel maker is Acerias Paz del Rio with a capacity of 270,000 metric tons per year (t/yr) of crude steel (accounting for about 40 percent of total production). The company has been under financial restructuring recently because of high debt. In early 2003, the GOC and the employees reached an agreement to save the company from liquidation. Under the agreement, the employees resigned their right to various annual premium compensation payments that were being used to create a capitalization fund. With those resources, the employees own 36 percent of the company. Several foreign companies have expressed interest in buying Acerias Paz del Rio including the Gerdau group from Brazil, the European consortium Acelor, and the Techint group from Argentina. The company, however, has not yet been sold. The Gerdau group purchased Diaco and Sidelpa, Acerias Paz del Rio's competitors, in January 2005 for USD 130 million.

¶16. Scrap metal is vital to the Colombian iron and steel industry but a tight scrap market is contributing to higher domestic steel prices. Colombia,s local iron and steel producers (Diaco, Acerias de Caldas, Sidoc, and Acerias de Sogamoso-responsible for 60 percent of total production) face rising steel prices caused by a recent surge in international demand that has reduced the local scrap supply. According to Juan Manuel Lesmes, Director of the Colombian Federation of Metal Producers (Fedemetal), Colombian suppliers export about 2,000 tons of scrap per month (valued at approximately USD 2 million). Colombia,s international scrap buyers are mainly Chinese and have indicated they would like to increase their purchases to 5,000 tons per month. In an effort to maintain local scrap supply and control prices, the GOC issued Decree 1771 on June 2, 2004. Decree 1771 imposed scrap export quotas of 4,700 tons of ferrous scrap (iron and steel) and 15,200 tons of non-ferrous scrap (copper, aluminum, and lead) every six months but the GOC ended the quotas in December 2004 out of concern they might violate WTO agreements. Local scrap prices have remained high due to the limited number of local scrap providers.

Precious Metals - Gold, Platinum, Silver

¶17. In 2004, the total production of precious metals (gold, platinum, and silver) was 47.5 tons and total exports of precious metals reached USD 576.5 million. According to the UPME Mining Director, gold production estimates are not very good because there is a considerable amount of gold contraband that is very difficult to estimate.

Gold

¶18. Colombia,s gold production rates have fluctuated recently. Production increased from 20.7 tons in 2002 to 46.5 tons in 2003. However in 2004, production fell to 37.6 tons. The 2003 boost in gold production was due to a change in tax policy that made production of gold in dore form more profitable than processing the gold into gold leaf. Gold leaf exports dropped precipitously in 2003 as a result, but gold exports increased from USD 94.4 million in 2002 to USD 585.2 million in 2003, falling to USD 556 million in 2004.

¶19. Colombia gold exploration relies on artesanal or traditional methods, and generally lacks large-scale. Small-scale Colombian operations, both artesanal and semi-modernized, continue to produce significant quantities of gold averaging 950,000 (declared) troy ounces per year over the last fifteen years according to the Colombian Central Bank. Three departments, Antioquia, Bolivar, and Cordoba, are the source for 90 percent of the total gold

production in the country, with Antioquia accounting for more than 50 percent. Colombia,s largest alluvial operation is El Bagre located by the Nechi River, which is owned by the domestic producer Mineros de Antioquia, S.A. El Bagre mining operations include three bucket line dredges and three Beaver dredges that process approximately 15 million cubic meters of material per year.

¶20. Colombia has two significant large-scale exploration projects: Murindo copper-gold mine and the Piedra Sentada Guachavez. The Murindo mine contains alluvial gold deposits and a large hard rock copper deposit at the La Rica mountain. The Piedra Sentada Guachavez gold prospect has abundant alluvial deposits. Foreign companies, particularly Greystar Resources and Anglo Gold Ashanti, are planning to expand exploration projects in Angostura, Norte de Santander department and San Martin and Barranco de Loba mines in Bolivar department.

Platinum

¶21. Colombia,s platinum production is less than one percent of the world total but production and exports have increased steadily over the last several years. Platinum production grew from 828 kg in 2003 to 1,160 kg in 2004. Platinum exports increased from approximately USD 8 million in 2002 to USD 19 million in 2003, reaching USD 20 million in 2004. All platinum production in Colombia is from placer deposits. Choco Department is the primary source of platinum and contains several mines, mainly in the San Juan Valley. Antioquia Department ranks second in production although smaller quantities are produced in the Departments of Bolivar, Cauca, Cordoba, Narino, and Valle del Cauca.

Silver

¶22. In Colombia, silver is recovered as a by-product of gold mining; no company is exclusively dedicated to the silver production. Over 80 percent of Colombia,s silver production occurs in the departments of Antioquia and Cordoba. Silver production increased 36 percent from 6,986 kg in 2002 to 9,511 kg in 2003, dropping to 8,189 kg in 2004. Exports of silver went from approximately USD 377,700 in 2002 to USD 678,400 in 2003, dropping to USD 550,300 in 2004.

Other Non-Precious Metals

¶23. Colombia,s total ferronickel exports increased from USD 414.7 million in 2003 to USD 626.1 million in 2004. Colombia,s only nickel producer is Cerro Matoso S.A., a subsidiary of BHP Billiton Plc. through QNI Limited. The Cerro Matoso deposit, located in the Department of Cordoba, southwestern Colombia, is one of the highest-grade lateritic nickel deposits in the world. The site has proven ore reserves of 39.5 million tons with a 2.3 percent nickel content. A 1999 plant expansion increased Cerro Matoso,s ferronickel production. A second production line was completed in January 2001 for USD 353 million. Cerro Matoso,s ferronickel production went from 47,868 tons in 2003 to 48,818 tons in 2004 due to increased capacity and strong nickel demand. Cerro Matoso hopes to increase production to 55,000 ton per year.

The Green

¶24. Colombia is a leading supplier of high-quality emeralds, providing approximately 50 percent of total world exports. While emerald production climbed from 8.96 million carats in 2003 to 9.82 million carats in 2004, the value of emerald exports decreased from USD 77.9 million in 2003 to USD 72.7 million in 2004. The common practice of injecting oil during emerald production to hide possible fractures has affected the reputation of Colombian emeralds in international markets. This practice may have negatively affected global interest in Colombian emeralds according to UPME,s Mining Director.

¶25. Colombia has about 150 emerald mining sites although some are not being exploited. The GOC leases mining rights to private business but illegal mining is also common. Legitimate mining interests operate in two major districts, Muzo and Chivor, located in the "Cordillera Oriental" region of the Andean mountains. The major mines of the Muzo district, located 100 kilometers north of Bogota, include Muzo, Cosquez, and Pena Blanca. Approximately three quarters of Colombian emerald production comes from about 60 locations belonging to the Coscuez mine. The Muzo mine is leased to the government for 10-year periods to the Sociedad de Mineros

Boyancences. The Chivor district, situated southeast of Bogota, contains two major mines, Chivor and Gachala. The Chivor mine is the only major privately owned emerald mine in Colombia.

The Future

¶26. Colombia's mining sector reforms have successfully enhanced the investment climate and paid off in increased demand for concessions. The GOC has focused its efforts on streamlining regulatory oversight, reducing incentives for illegal activity, particularly in the gold and emerald industries, and most importantly, improving the contract terms for potential investors. Thanks to these and similar reforms in the oil and gas sector, the mining and petroleum sector was the largest recipient of foreign direct investment in 2004 and is expected to remain the leading sector for foreign investment for the foreseeable future.
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